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RSC Policy Brief:
Medicaid Funding Issues

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In light of discussions about temporary increases in Medicaid matching funds being included in an economic stimulus package, the RSC has prepared the following policy brief providing background on the Medicaid funding formula and the implications of proposals currently under discussion.

Background: The Medicaid program, enacted in 1965, serves as a federal-state partnership providing entitlement health care coverage to certain low-income and disabled populations. Federal funding for the program is provided on a matching basis, according to a Federal Medical Assistance Percentage (FMAP) formula established in statute. The FMAP formula is based on a three-year rolling average that compares a state's per-capita income to national-per capita income—a formula designed to provide increased federal assistance to poorer states. For Fiscal Year 2008, 18 states have a match rate of 50% (the statutory minimum), while seven states have match rates at or above 70%.[1]

Concerns about the FMAP Formula: For several years, health policy experts have criticized the current Medicaid FMAP formula as not meeting its original intent, creating distortionary effects on funding levels between states by providing wealthier states with a strong incentive to increase entitlement spending using federal dollars. An independent analysis of data provided by the Centers for Medicare and Medicaid Services (CMS) indicates that states with ***higher*** concentrations of poverty actually have ***lower*** per-capita Medicaid spending—exactly the opposite result of FMAP's intended goal.[2] For instance, Vermont spent $7,508 per capita on

[1] Fiscal Year 2008 FMAP Table, available at http://aspe.hhs.gov/health/fmap08.htm (accessed January 18, 2008).
[2] Robert Helms, "The Medicaid Commission Report: A Dissent," (Health Policy Outlook #2, American Enterprise Institute, Washington, DC, January 2007), available at http://www.aei.org/publications/filter.all,pubID.25434/pub_detail.asp (accessed January 18, 2008).

Medicaid during 2005—the highest amount nationwide—yet its 2005 poverty level of 10.4% ranks 11th–lowest overall and nearly 30% lower than the national average of 13.3%.[3]

The prime reason for the disparity between states' per-capita Medicaid spending and relative poverty levels—a disparity which the FMAP formula was intended to remedy—lies in the perverse incentives the Medicaid match provides to states, particularly wealthier states that can more easily finance coverage expansions, to increase entitlement spending. Because the federal match rate cannot fall below the 50% statutory minimum, states have a diminished incentive to bring their Medicaid programs in line by controlling costs. A state receiving the minimum 50% match would need to cut overall Medicaid expenditures by $2 million to achieve $1 million in budgetary savings, while a state with a 70% FMAP match would need to cut overall Medicaid expenditures by $3,333,333 in order to achieve the same $1 million in net state savings. Thus the FMAP formula, by ensuring that federal expenditures will always meet or exceed state outlays, ***encourages*** states to increase their Medicaid entitlement spending during strong economic times and ***discourages*** states from enacting Medicaid reductions during times of fiscal austerity.

Legislative History: Congress has previously supported a temporary increase in the FMAP funding formula. Title IV of the Jobs and Growth Tax Relief and Reconciliation Act (P.L. 108-27) included $10 billion to fund an enhanced FMAP match for 15 months, along with an additional $10 billion dedicated to "temporary state fiscal relief." The Title IV provisions included a 2.95% increase in FMAP rates for the last two quarters of 2003 and the first three quarters of 2004. These provisions expired October 1, 2004 and were not renewed.

In general, House conservatives opposed this increase in Medicaid social welfare spending, but supported the underlying bill for the $350 billion in tax relief it contained, including reductions to dividend and capital gains rates which stimulated economic growth. The FMAP provisions were added in the Senate, and maintained in conference at the behest of several Senators who, according to news reports, insisted on its inclusion to vote for the larger package, which passed the Senate on the basis of Vice President Cheney's tie-breaking vote.

Recent State Actions: While some states have claimed that their looming budgetary difficulties have been caused by revenue losses related to recent economic uncertainty, unwise fiscal policies in many instances bear more responsibility. According to a November 2007 study by the non-partisan Kaiser Family Foundation, 31 states have announced Medicaid eligibility expansions during 2008, and 13 states plan benefit package expansions during this year. By contrast, only four states have proposed Medicaid eligibility reductions this year, and no state has proposed reducing benefits. In addition, the report notes that "few states have taken advantage of the flexibility to change benefits or impose cost sharing" as a result of provisions included in the Deficit Reduction Act of 2005 (P.L. 109-171), demonstrating states' continued focus on expanding entitlement programs rather than utilizing flexibility provided by Congress to construct new benefit packages that could reduce health costs.[4]

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[3] Ibid.; U.S. Census Bureau Small Area Income and Poverty Estimates, available at http://www.census.gov/cgi-bin/saipe/national.cgi?year=2005&ascii= (accessed January 18, 2008).

[4] Kaiser Family Foundation, "State Fiscal Conditions and Medicaid," (research report 7850-02, November 2007), available at http://kff.org/medicaid/upload/7580-02.pdf (accessed January 18, 2008).

The state Medicaid expansions proposed for the current fiscal year follow on the heels of additional expansions implemented during the last few years of economic growth, and further illustrate the distortionary effects of the FMAP formula. The promise of a generous federal match of at least 1:1 encourages states to expand their Medicaid populations and benefits beyond prudent limits, and slowing growth in state revenues has prompted calls for the federal government to assume yet more responsibility for states' poor planning decisions.

Conservative Concerns: Some conservatives may be troubled by talk of another attempt to increase the Medicaid FMAP formula – which some might call a "bailout" for states which over-extended entitlement promises over the last few years. The temporary FMAP increase enacted in 2003 over conservatives' concerns was designed to be just that: a one-time series of relief payments to states that over-extended their budgets during the late 1990s. A second "temporary" increase would only provide additional incentive for states to expand their Medicaid entitlement spending, knowing that the federal government will provide additional funding to make up their own budgetary shortfalls.

Including an FMAP enhancement as part of a "stimulus" package would not result in any actual economic stimulus. A higher match rate would only substitute federal dollars for state funding, providing no net economic benefit in either the short term or the long term. The only true effects would be long term, and potentially quite costly—increased entitlement spending at both the federal and state levels.

However, the discussion of Medicaid funding levels does provide conservatives with an opportunity to raise the important issue of entitlement reform. Rather than providing additional federal funds to states under the current FMAP formula, a more productive solution would entail comprehensive reform of the Medicaid funding mechanism. One possible solution would see Medicaid converted into a block grant program, allowing for predictable payments to states and enabling Congress to engage in a more rational attempt to control health care costs while setting clear national fiscal priorities. At a minimum, the existing FMAP formula needs a significant overhaul that would eliminate incentives for states to overspend by ensuring that federal Medicaid resources are directed to targeted low-income and disabled populations, not additional expansions of government-funded health care to other populations.

For further information on this issue see:

- *Federal Medical Assistance Percentages*
- *The Medicaid Commission Report: A Dissent*

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